



7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702

RIN 3133-AE90

Risk-Based Capital—Supplemental Rule

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed rule.

SUMMARY: The NCUA Board (Board) is seeking comment on a proposed rule that would amend the NCUA’s previously revised regulations regarding prompt corrective action (PCA). The proposal would delay the effective date of the NCUA’s October 29, 2015 final rule regarding risk-based capital (2015 Final Rule) for one year, moving the effective date from January 1, 2019 to January 1, 2020. During the extended delay period, the NCUA’s current PCA requirements would remain in effect. The proposal would also amend the definition of a “complex” credit union adopted in the 2015 Final Rule for risk-based capital purposes by increasing the threshold level for coverage from \$100 million to \$500 million. These proposed changes would provide covered credit unions and the NCUA with additional time to prepare for

the rule's implementation, and would exempt an additional 1,026 credit unions from the rule without subjecting the National Credit Union Share Insurance Fund (NCUSIF) to undue risk.

DATES: Comments must be received by [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit written comments, identified by RIN 3133-AE90, by any of the following methods (**Please send comments by one method only**):

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- NCUA Web Site: <http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx>. Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include “[Your name] – Comments on Proposed Rule: Risk-Based Capital—Supplemental Proposal” in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Gerard Poliquin, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

You can view all public comments on the NCUA's website at

<http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx> as submitted, except for those we cannot

post for technical reasons. The NCUA will not edit or remove any identifying or contact information from the public comments submitted. You may inspect paper copies of comments in the NCUA's law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9 a.m. and 3 p.m. To make an appointment, call (703) 518-6546, or send an e-mail to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: *Policy and Analysis:* Julie Cayse, Director, Division of Risk Management, Office of Examination and Insurance, at (703) 518-6360; Kathryn Metzker, Loss/Risk Analyst, Division of Risk Management, Office of Examination and Insurance, at (703) 548-2456; Julie Decker, Loss/Risk Analyst, Division of Risk Management, Office of Examination and Insurance, at (703) 518-3684; Aaron Langley, Risk Management Officer, Division of Analytics and Surveillance, Office of Examination and Insurance, at (703) 518-6387; *Legal:* John Brolin, Staff Attorney, Office of General Counsel, at (703) 518-6540; or by mail at National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314.

SUPPLEMENTARY INFORMATION:

I. Introduction

The NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. The agency performs this function by examining and supervising all federal credit unions, participating in the examination and supervision of federally insured, state-chartered

credit unions in coordination with state regulators, and insuring members' accounts at federally insured credit unions.¹ In its role as administrator of the NCUSIF, the NCUA insures and regulates approximately 5,573 federally insured credit unions, holding total assets exceeding \$1.4 trillion and representing approximately 111 million members.²

At its October 2015 meeting, the Board issued the 2015 Final Rule to amend Part 702 of the NCUA's PCA regulations to require that credit unions taking certain risks hold capital commensurate with those risks.³ The risk-based capital provisions of the 2015 Final Rule apply only to federally insured, natural-person credit unions with quarter-end total assets exceeding \$100 million. The overarching intent of the 2015 Final Rule is to reduce the likelihood that a relatively small number of high-risk outlier credit unions would exhaust their capital and cause large losses to the NCUSIF. Under the Federal Credit Union Act (FCUA), federally insured credit unions are collectively responsible for replenishing losses to the NCUSIF.⁴

The 2015 Final Rule restructures the NCUA's PCA regulations and makes various revisions, including amending the agency's current risk-based net worth requirement by replacing the risk based net worth ratio with a new risk-based capital ratio for federally insured, natural-person credit unions (credit unions). The risk-based capital requirements set forth in the 2015 Final

¹ As of December 31, 2017, within the nine states that allow privately insured credit unions, approximately 116 state-chartered credit unions are privately insured and are not subject to the NCUA's regulation and oversight.

² Based on December 31, 2017 Call Report Data.

³ 80 FR 66625 (Oct. 29, 2015).

⁴ See 12 U.S.C. 1782(c)(2)(A) (The FCUA requires that each federally insured credit unions to pay a federal share insurance premium equal to a percentage of the credit union's insured shares to ensure that the NCUSIF has sufficient reserves to pay potential share insurance claims by credit union members, and to provide assistance in connection with the liquidation or threatened liquidation of federally insured credit unions in troubled condition.).

Rule are more consistent with the NCUA's risk-based capital ratio measure for corporate credit unions and, as the law requires, are more comparable to the regulatory risk-based capital measures used by the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System, and Office of the Comptroller of Currency (Other Banking Agencies). The 2015 Final Rule also eliminates several provisions in the NCUA's current PCA regulations, including provisions related to the regular reserve account, risk-mitigation credits, and alternative risk weights.

The 2015 Final Rule is currently set to become effective on January 1, 2019. The NCUA delayed the effective date until January 1, 2019 to provide credit unions and the NCUA sufficient time to make the necessary adjustments, such as systems, processes, and procedures; to reduce the burden on affected credit unions.

II. Legal Authority

In 1998, Congress enacted the Credit Union Membership Access Act (CUMAA).⁵ Section 301 of CUMAA added section 216 to the FCUA,⁶ which required the Board to adopt by regulation a system of PCA to restore the net worth of credit unions that become inadequately capitalized.⁷

⁵ Public Law 105–219, 112 Stat. 913 (1998).

⁶ 12 U.S.C. 1790d.

⁷ The risk-based net worth requirement for credit unions meeting the definition of “complex” was first applied on the basis of data in the Call Report reflecting activity in the first quarter of 2001. 65 FR 44950 (July 20, 2000). The NCUA's risk-based net worth requirement has been largely unchanged since its implementation, with the following limited exceptions: revisions were made to the rule in 2003 to amend the risk-based net worth requirement for MBLs, 68 FR 56537 (Oct. 1, 2003); revisions were made to the rule in 2008 to incorporate a change in the statutory

Section 216(b)(1)(A) requires the Board to adopt by regulation a system of PCA for federally insured credit unions “consistent with” section 216 of the FCUA and “comparable to” section 38 of the Federal Deposit Insurance Act (FDI Act).⁸ Section 216(b)(1)(B) requires that the Board, in designing the PCA system, also take into account the “cooperative character of credit unions” (i.e., credit unions are not-for-profit cooperatives that do not issue capital stock, must rely on retained earnings to build net worth, and have boards of directors that consist primarily of volunteers).⁹ The Board initially implemented the required system of PCA in 2000,¹⁰ primarily in Part 702 of the NCUA’s Regulations, and most recently made substantial updates to the regulation in October 2015.¹¹

The purpose of section 216 of the FCUA is to “resolve the problems of [federally] insured credit unions at the least possible long-term loss to the [NCUSIF].”¹² To carry out that purpose, Congress set forth a basic structure for PCA in section 216 that consists of three principal components: (1) a framework combining mandatory actions prescribed by statute with discretionary actions developed by the NCUA; (2) an alternative system of PCA to be developed by the NCUA for credit unions defined as “new;” and (3) a risk-based net worth requirement to apply to credit unions the NCUA defines as “complex.”

definition of “net worth,” 73 FR 72688 (Dec. 1, 2008); revisions were made to the rule in 2011 to expand the definition of “low-risk assets” to include debt instruments on which the payment of principal and interest is unconditionally guaranteed by NCUA, 76 FR 16234 (Mar. 23, 2011); and revisions were made in 2013 to exclude credit unions with total assets of \$50 million or less from the definition of “complex” credit union, 78 FR 4033 (Jan. 18, 2013).

⁸ 12 U.S.C. 1790d(b)(1)(A); *see also* 12 U.S.C. 1831o (Section 38 of the FDI Act setting forth the PCA requirements for banks).

⁹ 12 U.S.C. 1790d(b)(1)(B).

¹⁰ 12 CFR Part 702; *see also* 65 FR 8584 (Feb. 18, 2000) and 65 FR 44950 (July 20, 2000).

¹¹ 80 FR 66625 (Oct. 29, 2015).

¹² 12 U.S.C. 1790d(a)(1).

Among other things, section 216(c) of the FCUA requires the NCUA to use a credit union's net worth ratio to determine its classification among five "net worth categories" set forth in the FCUA.¹³ Section 216(o) generally defines a credit union's "net worth" as its retained earnings balance,¹⁴ and a credit union's "net worth ratio," as the ratio of its net worth to its total assets.¹⁵ As a credit union's net worth ratio declines, so does its classification among the five net worth categories, thus subjecting it to an expanding range of mandatory and discretionary supervisory actions.¹⁶

Section 216(d)(1) of the FCUA requires that the NCUA's system of PCA include, in addition to the statutorily defined net worth ratio requirement applicable to federally insured natural-person credit unions, "a risk-based net worth"¹⁷ requirement for insured credit unions that are complex, as defined by the Board"¹⁸ The FCUA directs the NCUA to base its definition of "complex" credit unions "on the portfolios of assets and liabilities of credit unions."¹⁹ It also

¹³ 12 U.S.C. 1790d(c).

¹⁴ 12 U.S.C. 1790d(o)(2).

¹⁵ 12 U.S.C. 1790d(o)(3).

¹⁶ 12 U.S.C. 1790d(c) – (g); 12 CFR 702.204(a) – (b).

¹⁷ For purposes of this rulemaking, the term "risk-based net worth requirement" is used in reference to the statutory requirement for the Board to design a capital standard that accounts for variations in the risk profile of complex credit unions. The term "risk-based capital ratio" is used to refer to the specific standards established in the 2015 Final Rule to function as criteria for the statutory risk-based net worth requirement. The term "risk-based capital ratio" is also used by the Other Banking Agencies and the international banking community when referring to the types of risk-based requirements that are addressed in the 2015 Final Rule. This change in terminology throughout the proposal would have no substantive effect on the requirements of the FCUA, and is intended only to reduce confusion for the reader.

¹⁸ 12 U.S.C. 1790d(d)(1).

¹⁹ 12 U.S.C. 1790d(d).

requires the NCUA to design a risk-based net worth requirement to apply to such “complex” credit unions.²⁰

III. Proposed Rule

Under §702.103 of the NCUA’s 2015 Final Rule, a credit union is defined as “complex” and the NCUA’s risk-based capital ratio measure is applicable only if the credit union’s quarter-end total assets exceed \$100 million, as reflected in its most recent Call Report. Consistent with the spirit and intent of Executive Order 13777, the NCUA further analyzed the impact of the NCUA’s risk-based capital requirements and the portfolios of assets and liabilities of credit unions to identify potential ways to reduce regulatory burden on credit unions.²¹

Based on the NCUA’s analysis, which is discussed in more detail below, the Board believes that \$500 million in total assets would be a more appropriate threshold level for defining a complex credit union, and therefore subjecting it to the risk-based capital requirement. Increasing the threshold level to \$500 million in assets would reduce regulatory burden on credit unions by more closely tailoring the applicability of the NCUA’s risk-based capital requirement to cover only those credit unions that, if they failed, individually could present an undue risk of loss to the NCUSIF. This amendment would exempt an additional 1,026 credit unions – a total of 90

²⁰ *Id.*

²¹ The Board has always intended to periodically review the threshold of a complex credit union, as noted in the preamble to the 2015 proposed Risk Based Capital Rule. 80 FR 4339, 4378 (January 27, 2015).

percent²² of all credit unions - from the 2015 Final Rule's risk-based capital requirements.

However, approximately 85 percent of the complex assets and liabilities and 76 percent of the total assets in the credit union system would still be subject to the risk-based capital requirement.²³ Accordingly, consistent with requirements of section 216(d)(1) of the FCUA, proposed §702.103 would provide that, for purposes of §702.102, a credit union is defined as “complex,” and a risk-based capital ratio requirement is applicable, only if the credit union's quarter-end total assets exceed \$500 million, as reflected in its most recent Call Report.

Under the 2015 Final Rule, the NCUA determined that credit unions exceeding the \$100 million asset-size threshold had portfolios of assets and liabilities that were complex based on the products and services in which such credit unions engaged. As explained further below, the \$100 million asset-size threshold was developed as a proxy measure based on a detailed analysis performed by the NCUA. The threshold set forth a clear demarcation line, above which the NCUA determined all credit unions engaged in complex activities, and where almost all such credit unions (99 percent) were involved in multiple complex activities.²⁴ The NCUA continues to believe that using a single asset-size threshold is appropriate, as it is clear, logical, and easy to administer. Moreover, using a single asset-size threshold provides regulatory relief for smaller institutions, and eliminates the potential unintended consequences of having a checklist of activities that would determine complexity on an institution-by-institution basis.

²² Based on December 31, 2017 Call Report data. For comparison, if the threshold were to remain at \$100 million about 72 percent of all credit unions would be exempt.

²³ For comparison, if the threshold were to remain at \$100 million about 98 percent of the complex assets and liabilities and 93 percent of the total assets in the credit union system would be subject to the risk based capital requirement.

²⁴ 80 FR 66625, 66663 (Oct. 29, 2015).

The \$100 million asset threshold adopted in the 2015 Final Rule for determining whether a credit union is complex was based on a complexity index (original complexity index or OCI). The OCI counted the number of complex products and services provided by credit unions based on the following indicators:

- Member Business Loans
- Participation Loans
- Interest-Only Loans
- Indirect Loans
- Real Estate Loans
- Non-Federally Guaranteed Student Loans
- Investments with Maturities of Greater than Five Years (where the investments are greater than one percent of total assets)
- Non-Agency Mortgage-Backed Securities
- Non-Mortgage Related Securities With Embedded Options
- Collateralized Mortgage Obligations/Real Estate Mortgage Investment Conduits
- Commercial Mortgage-Related Securities
- Borrowings (Draws Against Lines of Credit, Borrowing Repurchase Transactions, Other Notes, Promissory Notes, and Interest Payable)
- Repurchase Transactions
- Derivatives
- Internet Banking

As discussed in more detail in the 2015 Final Rule, these products and services were determined by the NCUA to be good indicators of complexity.²⁵

To define “complex” credit unions for the 2015 Final Rule, the NCUA used the original complexity index to analyze June 30, 2014 and March 31, 2015 Call Report data. Based on the OCI, for credit unions with more than \$100 million in assets, 100 percent engaged in offering at least one complex activity; 99 percent engaged in two or more complex activities; and 87 percent engaged in four or more complex activities. Accordingly, the Board determined it was appropriate to set the asset size threshold for “complex” credit unions at \$100 million in total assets, subjecting credit unions with more than \$100 million in assets to the NCUA’s risk-based capital requirements.

As discussed in more detail below, the OCI did not take into account the volume of the complex activity engaged in by such credit unions.

Following a careful review of the 2015 Final Rule by the NCUA’s regulatory reform task force,²⁶ the Board is now proposing to revise the original complexity index (revised complexity index or

²⁵ 80 FR 66625, 66663 (Oct. 29, 2015). The 2015 Final Rule states “For the purpose of defining a complex credit union, assets include tangible and intangible items that are economic resources (products and services) that are expected to produce economic benefit (income), and liabilities are obligations (expenses) the credit union has to outside parties. The Board recognizes there are products and services—which under GAAP are reflected as the credit unions’ portfolio of assets and liabilities — in which credit unions are engaged that are inherently complex based on the nature of their risk and the expertise and operational demands necessary to manage and administer such activities effectively. Thus, credit unions offering such products and services have complex portfolios of assets and liabilities for purposes of NCUA’s risk-based net worth requirement.”

RCI), and to apply a new complexity ratio (complexity ratio or CR) for analyzing the portfolios of assets and liabilities of credit unions to determine which are “complex.” The RCI would amend 6 of the indicators in the original complexity index so the index will more accurately reflect “complexity” in credit unions and take into account certain regulatory changes that were made after the 2015 Final Rule was approved. The revised complexity index would be the same as the original complexity index, with the following six changes:

- Replace the indicator for “member business loans” with an indicator for “commercial loans” to reflect changes to the NCUA’s member business lending rule,²⁷ and current Call Report data collection requirements.
- Replace the indicator for “participation loans” (which included participation loans sold and participation loans held) with an indicator for “participation loans sold” to restrict the indicator to the most complex component of participation loans.
- Replace the indicator for “interest-only loans” to exclude first-lien mortgages. The remaining interest only loans include complex payment options. For example, only requiring monthly payments of interest during draw periods.
- Remove the indicator for “internet banking” because it has become a typical mechanism for members to transact business with most credit unions, with 78 percent of credit unions engaging in some type of internet banking. Also, it is not an asset or liability - therefore there is no suitable way to translate the volume into a financial measure for purposes of defining complex.

²⁶ See 82 FR 39702, 39706 (Aug. 22, 2017).

²⁷ See 12 CFR 723.2; and 81 FR 13529, 13538 (March 14, 2016).

- Remove the indicator for “investments with maturities greater than five years (where the investments are greater than one percent of total assets)” because the indicator is adequately captured in the other index components.
- Replace the indicator for “real estate loans (where the loans are greater than five percent of assets and/or sold mortgages)” with an indicator for “sold mortgages” to account for the most complex component of real estate loans.

The NCUA believes the revised complexity index would provide a more accurate methodology, based on the assets and liabilities of credit unions, for identifying when credit unions engage in complex activities and defining credit unions as “complex.” Table 1 shows that, among credit unions with \$500 million or more in total assets, 100 percent engage in at least one complex activity, and 96 percent engage in three or more complex activities.

Table 1: Revised Complexity Index by Asset Category, 2017Q4 Call Report Data

Asset Category	No. of Credit Unions	Average Index Value	Median Index Value	Index >= 1	Index >= 2	Index >= 3	Index >= 5	Index >= 6
<\$100M	4,016	0.8	0.0	41%	21%	10%	2%	1%
\$100M-\$250M	692	3.7	4.0	98%	89%	73%	32%	16%
\$250M-\$500M	334	4.9	5.0	99%	96%	88%	57%	40%
\$500M-\$750M	149	5.7	6.0	100%	98%	96%	73%	53%
\$750M-\$1B	95	6.1	7.0	100%	100%	97%	79%	64%
\$1B+	287	7.0	7.0	100%	98%	96%	88%	77%

In addition to the revised complexity index, the NCUA is also proposing to use a ratio of complex assets and liabilities to total assets (complexity ratio or CR) to evaluate the extent to

which credit unions are involved in complex activities. The CR, when used in conjunction with the revised complexity index, takes into account the volume of the complex activity engaged in by complex credit unions and provides a more accurate measure of credit union complexity.²⁸ The numerator of the CR would be the dollar value sum of the complex assets and the liabilities held by a credit union, where complex assets and liabilities are determined using the same complexity indicators as used in the RCI. The denominator of the CR would be the total assets of the credit union.

As shown in Table 2 below, credit unions with greater than \$500 million in total assets hold complex assets and liabilities as a larger share of their total assets than smaller credit unions. The complexity ratio increases from 23 percent among credit unions with less than \$500 million in assets to 40 percent among credit unions with more than \$500 million in assets. Of the \$497 billion in complex assets and liabilities in the credit union system, \$423 billion (85 percent) - the majority of complex assets and liabilities in the credit union system - are held among credit unions with more than \$500 million in assets.²⁹

²⁸ See 80 FR 66625, 66661 (Oct. 29, 2015) (As pointed out by at least one commenter, credit unions should not be considered complex unless complex activities are undertaken in significant volumes. The commenter provided the following example: a credit union that lends a member \$60,000 to purchase new equipment for his bakery is engaged in member business lending, but that credit union should not be designated as complex by virtue of that single loan—assuming it is not a significant share of the credit union’s assets.).

²⁹ Credit unions with assets between \$250 million and \$500 million hold a higher share of their portfolio in complex assets (32 percent) than the entire group of credit unions below \$500 million in assets (23 percent), but it remains below the share of complex assets in credit unions above \$500 million in assets (40 percent).

Table 2: Complexity Ratio by Asset Categories, 2017Q4 Call Report Data

Asset Category	No. of Credit Unions	Complex Assets and Liabilities	Total Assets	Complex Ratio	Share of Complex A & L in the Credit Union System	Cumulative Share of Complex A & L in the Credit Union System
<\$500M	5,042	74,600	330,545	23%	15%	15%
>\$500M	531	422,553	1,048,289	40%	85%	100%

Table 3 below shows the share of credit unions in each asset category above various complex ratio thresholds. Larger credit unions are much more likely to have a significant share of their balance sheet in complex assets and liabilities. Nearly all credit unions (95 percent) with more than \$500 million in assets have complex assets and liabilities greater than 10 percent of their total assets, and 66 percent have complex assets and liabilities greater than 30 percent of their total assets.

Table 3: Complexity Ratio above Various Thresholds by Asset Categories, 2017Q4

Asset Category	Complex Ratio > 10%	Complex Ratio > 20%	Complex Ratio > 30%
<\$500M	29%	18%	11%
>\$500M	95%	84%	66%

In general, two-thirds of credit unions with more than \$500 million in total assets have complex assets and liabilities ratios above 30 percent. Only 11 percent of credit unions with less than \$500 million have complexity ratios above 30 percent.³⁰

³⁰ Credit unions with assets between \$250 million and \$500 million are more likely to have a CR greater than 10 percent (88 percent) than the entire group of credit unions below \$500 million in assets (29 percent), but it remains

Using both the revised complexity index and the complexity ratio to determine the appropriate threshold for defining complex credit unions would exclude approximately 90 percent of credit unions from the risk-based capital requirement, while still covering approximately 76 percent of the assets held by federally insured credit unions.³¹ Moreover, the revised definition of a complex credit union would not represent undue risk to the NCUSIF, nor significantly decrease the level of complex assets and liabilities covered by the risk-based capital requirement. Even though the percent of total assets covered by the rule would fall from 93 percent³² to 76 percent when compared to the \$100 million threshold adopted in the 2015 Final Rule,³³ 85 percent of complex assets and liabilities would still be covered.

In addition, if the historical trends in changes to the composition of the credit union community continue, the share of total assets covered by the rule will rise in the future, potentially reaching 90 percent of total assets within the next 10 years. Also, the higher asset threshold still captures those credit unions that, if they failed, individually could present an undue risk of loss to the NCUSIF. In addition, if the historical trends in changes to the composition of the credit union community continue and historical probability of failure and loss given failure rates (excluding fraud related failures) for credit unions with total assets between \$100 and \$500 million and

below the share of complex assets in credit unions above \$500 million in assets (95 percent). Further, the difference widens significantly for CRs above 10 percent. Less than half (47 percent) of credit unions with assets between \$250 million and \$500 million have a CR greater than 30 percent, whereas over two-thirds of credit unions with more than \$500 million in assets have a CR greater than 30 percent.

³¹ Based on December 31, 2017 Call Report data.

³² Based on December 31, 2017 Call Report data, 93 percent of credit union assets would be covered based on the \$100 million threshold established by the 2015 Final Rule.

³³ Based on December 31, 2017 Call Report data.

those with total assets over \$500 million remain the same, total losses to the NCUSIF over the next 10 years would likely be significantly larger for credit unions with more than \$500 million in assets than for those with assets between \$100 million and \$500 million.

Table 4: Credit Unions Bound by Risk-Based Capital, 2017Q4 Call Report Data

Asset Category	No. of Complex Credit Unions Bound by Risk-Based Capital	Capital Required over the Net Worth Ratio	Total Assets
Assets \$100M-\$500M	284	\$165 Million	\$69 Billion
Assets > \$500M	221	\$635 Million	\$370 Billion
Total	505	\$800 Million	\$439 Billion

Under the 2015 Final Rule, an estimated 505 credit unions would face higher required capital levels as a result of risk-based capital requirements. These 505 credit unions have total assets of \$439 billion and the 2015 Final Rule would raise their required capital levels by approximately \$800 million above what is required by the net worth ratio.³⁴ Under this proposal, the 284 credit unions with assets between \$100 and \$500 million would no longer have higher required capital levels as a result of risk-based capital requirements. However, as reflected in Table 4, this proposal would maintain most of the credit union assets subject to higher capital requirements, and incremental capital required by risk-based capital, under the 2015 Final Rule.

³⁴ Based on December 31, 2017 Call Report data. It is important to note that almost all of these credit unions already hold enough capital to meet either the risk-based capital requirements or the net-worth-based capital requirements.

Exempting credit unions with assets between \$100 million and \$500 million represents approximately 16 percent of the total assets of credit unions with required capital levels above what is required by the net worth ratio, and about 21 percent of the incremental capital the system is required to hold under the 2015 Final Rule. However, this proposal still encompasses approximately 84 percent of the total assets of credit unions with required capital levels above what is required by the net worth ratio, and almost 80 percent of the incremental capital the system is required to hold under the 2015 Final Rule.

Under the 2015 Final Rule, a net of 20 credit unions with total assets of \$11.5 billion would have a lower PCA classification with a capital shortfall of \$84 million.³⁵ Under this proposal, 6 credit unions (net) with total assets of \$8.8 billion would have a lower PCA classification and a capital deficiency of \$71 million. Therefore, this proposal encompasses approximately 80 percent of the downgraded credit union assets and approximately 85 percent of the capital shortfall for these institutions.

The Board also notes the NCUSIF is much stronger today than it was in 2015 when the agency passed the 2015 Final Rule. The equity ratio of the NCUSIF was 1.29 percent in 2015. In 2018, the NCUSIF equity ratio will be 1.39 percent even after an equity distribution of \$736 million is paid to credit unions. The total funds held in the NCUSIF will be approximately \$16 billion after the equity distribution this year, about \$3.5 billion more than the \$12.4 billion held in the fund in 2015.

³⁵ Based on December 31, 2017 Call Report Data.

The NCUA will continue to address any deficiencies in the capital levels of credit unions with \$500 million or less in assets through the examination process.³⁶ Sound capital levels are vital to the long-term health of all credit unions. Credit unions need to hold capital commensurate with their risk. Balancing proper capital accumulation with product offering and pricing strategies helps ensure credit unions are able to provide affordable member services over time. Credit unions are already expected to incorporate into their business models and strategic plans provisions for maintaining prudent levels of capital.

Also, the Board wants to clarify for commenters that the standard under the Regulatory Flexibility Act for how the NCUA defines a “small credit union”³⁷ is different from the standard under the FCUA for how the agency defines “complex credit union” for purposes of the risk-based net worth requirement.³⁸ While both definitions currently use an asset threshold of greater than \$100 million in total assets, the thresholds were arrived at using different methodologies. The methodologies necessarily vary to address the different applicable statutory provisions.³⁹ This proposal addresses and amends only the NCUA’s definition of “complex” credit unions as that term is defined under the 2015 Final Rule. It does not address or propose to amend the

³⁶ See, e.g., §702.102(b) (Authorizes the NCUA Board to reclassify a well-capitalized credit union as adequately capitalized and may require an adequately capitalized or undercapitalized credit union to comply with certain mandatory or discretionary supervisory actions as if it were classified in the next lower capital category.).

³⁷ NCUA Interpretative Ruling and Policy Statement 15-1, available at <https://www.ncua.gov/regulation-supervision/Pages/rules/interpretive-rulings-policy-statements.aspx>.

³⁸ 80 FR 66625, 66663-66664 (October 29, 2015).

³⁹ Compare 80 FR 66663-66664, with 80 FR 57512, 57514-57516 (Sept. 24, 2015).

NCUA's current definition of "small credit unions" for purposes of the Regulatory Flexibility Act.⁴⁰

V. Effective Date of the 2015 Final Rule

The Board initially established the effective date of the 2015 Final Rule as January 1, 2019 to provide credit unions and the NCUA with an extended period to make necessary adjustments to systems, processes, and procedures, and to reduce the burden on affected credit unions in meeting the new requirements. Based on feedback from the credit union community and agency staff, and that the agency is proposing to change the definition of complex credit union, the Board believes it is necessary and beneficial to delay the effective date of the 2015 Final Rule as amended by this proposal by one year. Extending the effective date would provide covered credit unions additional time to adjust systems, processes, and procedures; and would help smooth the transition for complex credit unions affected by the requirements of the 2015 Final Rule.

Until the 2015 Final Rule's effective date, the NCUA's current PCA regulation will remain in effect. The NCUA will continue to enforce the capital standards currently in place and address any supervisory concerns through existing regulatory and supervisory mechanisms. The Board believes that, given the facts above, extending the implementation period of the 2015 Final Rule for an additional year would be reasonable and would not pose undue risk to the NCUSIF.

⁴⁰ 5 U.S.C. 601 *et seq.*

Accordingly, the Board proposes to change the effective date for the 2015 Final Rule, and any changes to that rule finalized as part of this rulemaking, from January 1, 2019 to January 1, 2020.

VI. Impact of the Proposed Regulation

The proposed rule will lower the overall impact of the 2015 Final Rule by reducing the number of credit unions subject to the risk-based capital requirements of the rule. By increasing the threshold for defining a complex credit union from more than \$100 million to more than \$500 million in assets, an additional 1,026 credit unions would be exempt from the 2015 Final Rule's risk-based capital requirements. This represents significant burden relief for these relatively small credit unions, as half of them have assets of \$190 million or less. The proposed new definition of complex credit union would exempt a total of 90 percent (5,042) of all credit unions as of December 31, 2017.⁴¹ For comparison, if the threshold were to remain at \$100 million only about 72 percent of all credit unions would be exempt.

While under this proposal 9 out of 10 credit unions would be exempt, these institutions only hold 24 percent of total assets in the credit union system and 15 percent of complex assets and liabilities.⁴² Thus, approximately 85 percent of the complex assets and liabilities and 76 percent

⁴¹ This proposal would limit risk-based capital requirements to only credit unions with assets of more than \$500 million compared to the Other Banking Agencies' risk-based capital standards that apply to banks of all sizes. As of December 31, 2017, there were 1,450 and 4,294 FDIC-insured banks with assets of \$100 million and \$500 million or less, respectively.

⁴² Credit unions with assets between \$100 million and \$500 million make up 17 percent of assets in the credit union system, and only hold 13 percent of complex assets and liabilities.

of the total assets in the credit union system would still be subject to the risk based capital requirement.⁴³

The credit unions that would be defined as complex under this proposal have estimated aggregate and average risk-based capital ratios of 16.8 and 17.2 percent, respectively. The aggregate risk-weighted assets to total assets ratio is 63 percent for complex credit unions under this proposal.⁴⁴

Table 5 shows the distribution of estimated risk-based capital ratios for all complex credit unions based on this proposed rule.

Table 5: Distribution of Estimated Risk Based Capital Ratios for Complex Credit Unions

RBC Ratio	<10%	10-13%	13-16%	16-20%	20-30%	30-50%	> 50%
# of CUs	7	110	153	144	101	14	2

As shown in Table 5 above, most complex credit unions will have a risk-based capital ratio well in excess of the 10 percent level required to be well capitalized. Under this proposal, six complex credit unions with total assets of \$8.8 billion would have a lower capital classification,

⁴³ For comparison, if the threshold were to remain at \$100 million about 98 percent of the complex assets and liabilities and 93 percent of the total assets in the credit union system would still be subject to the risk-based capital requirement.

⁴⁴ By way of comparison, the bank aggregate total risk-weighted assets to total assets ratio is 72.4 percent as of December 31, 2017. Further, complex credit unions maintain a median risk-based capital ratio of 15.8 percent compared to a bank median risk-based capital ratio of 15.9 percent. Bank comparisons exclude banks with less than \$50 million in total assets and more than \$60 billion in total assets to arrive at a more comparable asset profile to credit unions.

with a capital shortfall of approximately \$71 million.⁴⁵ Overall, 98.7 percent of all complex credit unions are well capitalized under this proposed rule.

Credit unions often hold some margin above regulatory capital requirements. Table 6 below provides a comparison of the margins complex credit unions currently hold in excess of both the net worth ratio requirement and the risk-based capital requirement.

Table 6: Distribution of Net Worth Ratio and Risk-Based Capital Ratio for Complex Credit Unions Under this Proposal

# of CUs	Less than Well Capitalized	Well Capitalized to Well + 2%	Well Capitalized + 2% to + 3.5%	Well Capitalized + 3.5% to + 5%	Greater than Well Capitalized + 5%
Net Worth Ratio	< 7%	7% - 9%	9% - 10.5%	10.5% -12%	> 12%
RBC Ratio	< 10%	10% - 12%	12% - 13.5%	13.5% - 15%	>15%
Net Worth Ratio	2	90	166	141	132
RBC Ratio	7	54	82	88	300

Both measures indicate the large majority of complex credit unions hold margins well above the levels required to be well-capitalized.

⁴⁵ Of the 531 impacted credit unions, only 7, or 1.3 percent, would have less than the 10 percent risk-based capital requirement to be well capitalized. Of these, one has a net worth ratio less than 7 percent and is therefore not a new downgrade in capital classification, but already categorized as less than well capitalized. If the asset threshold for the definition of complex credit union remained at \$100 million, a net of 20 credit unions with total assets of \$11.5 billion would have a lower capital classification, with a capital shortfall of approximately \$84 million.

The NCUA also analyzed complex credit unions to determine whether the net worth or risk-based capital requirement would require a credit union to hold more dollars of capital. Table 7 below summarizes the distribution of credit unions by the ratio of risk-weighted assets to total assets for credit unions bound by each capital requirement.

Table 7: Distribution of Risk-Weighted Assets to Total Assets Ratios for Complex Credit Unions by Governing Capital Requirement

	Total #	Risk Weighted Assets / Total Assets						
		Avg.	< 50%	50-60%	60-70%	70-80%	80-90%	> 90%
# Bound by Net Worth Ratio	310	58.9%	49	101	147	10	2	1
# Bound by Risk Based Capital	221	71.9%	0	3	81	128	6	3

Forty-two percent of complex credit unions (221 complex credit unions with \$370.3 billion in total assets) are estimated to have a higher minimum capital requirement in terms of dollars under the risk-based capital ratio than the net worth ratio.⁴⁶ These 221 complex credit unions have a notably higher risk profile than the other 310 complex credit unions. The ratio of average risk weighted assets to total assets for the 221 complex credit unions is 72 percent, compared

⁴⁶ The required dollar amount for risk based capital is calculated as [(risk-weighted assets times 10 percent) – allowance for loan losses – equity acquired in merger + total adjusted retained earnings acquired through business combinations + NCUA share insurance capitalization deposit + goodwill + identifiable intangible assets] – (total assets x 7 percent). Complex credit unions in Table 7 are categorized by whichever calculation results in a higher dollar volume.

with 59 percent for the remaining 310 complex credit unions. Therefore, relative to what qualifies as capital for risk-based capital purposes, these institutions must hold more net worth in dollars to achieve a well-capitalized designation over what the net worth ratio requires.

In addition, despite holding a greater share of risk-weighted assets, the risk-based capital-bound group of 221 complex credit unions also has, on average, a net worth ratio that is 100 basis point below the net worth ratio of the other 310 complex credit unions.⁴⁷ Table 7 highlights the distribution of credit unions by risk weighted assets to total assets depending on whether the risk-based capital requirement necessitates more capital than the net worth ratio. The risk-based capital-bound group of 221 complex credit unions would have to retain more net worth in dollars than what is currently required due to the net worth ratio to satisfy the well-capitalized threshold. However, over 97 percent (215) of these institutions already hold more than enough capital to meet the risk-based capital requirement.

VI. Request for Comment

The Board is requesting comment on all aspects of the changes proposed in this proposed rule.

In particular, the agency requests comments on:

⁴⁷ The average net worth ratio is 10.3 percent for the 212 complex credit unions bound by risk-based capital while the average net worth ratio for the 310 complex credit unions bound by the net worth ratio is 11.4 percent.

1. Whether the definition of a complex credit union, as defined under §701.103 of the 2015 Final Rule, should be amended to increase the threshold level for coverage from *more than \$100 million in total assets* to *more than \$500 million in total assets*?
2. Whether the implementation date for the 2015 Final Rule should be amended to extend the effective date of the rule until January 1, 2020?

VII. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) generally requires that, in connection with a notice of proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities. A regulatory flexibility analysis is not required, however, if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include credit unions with assets less than \$100 million)⁴⁸ and publishes its certification and a short, explanatory statement in the *Federal Register* together with the rule.

The proposed amendments to the 2015 Final Rule and part 702 would only affect complex credit unions, which are those with greater than \$100 million in assets under the 2015 Final Rule and

⁴⁸ See 80 FR 57512 (Sept. 24, 2015).

would be amended to cover only those with greater than \$500 million in assets under this proposal. As a result, credit unions with \$100 million or less in total assets would not be affected by this proposal. Accordingly, the NCUA certifies that this proposal will not have a significant economic impact on a substantial number of small credit unions.

Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden on regulated entities or modifies an existing burden.⁴⁹ For purposes of the PRA, a paperwork burden may take the form of a reporting, disclosure, or recordkeeping requirement, each referred to as an information collection. The NCUA may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number.

The proposed changes to part 702 would increase the asset size of credit unions identified as complex from greater than \$100 million to greater than \$500 million. This change would reduce the number of credit unions who must comply with recordkeeping requirements prescribed by §702.101(b). Therefore, the burden cleared under OMB number 3133-0191 will be revised to reflect the reduction in the number of respondents.⁵⁰

⁴⁹ 44 U.S.C. 3507(d).

⁵⁰ Proposed revisions to OMB control number 3133-0191 have been submitted to OMB for approval in accordance with 5 CFR 1320.11.

Title of Information Collection: Prompt Corrective Action – Risk-Based Capital.

OMB Control Number: 3133-0191.

Affected Public: Private Sector: Not-for-profit institutions – Complex Credit Unions.

Estimated Number of Respondents: 531.

Estimated Number of Responses per Respondent: 1.

Estimated Hours Per Response: 40.

Estimated Total Annual Burden Hours: 21,240.

By exempting credit unions with assets between \$100 million and \$500 million, the NCUA estimates that the burden under this proposed rule would be 41,040 fewer hours.

The Board invites comment on (a) whether the collections of information are necessary for the proper performance of the agency's function, including practical utility; (b) the accuracy of estimates of the burden of the information collections, including the validity of the methodology and assumptions used; (c) ways to enhance the quality, utility, and clarity of the information being collected, and (d) ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology.

All comments are a matter of public record. Comments regarding the information collection requirements of this rule should be sent to (1) Dawn Wolfgang, NCUA PRA Clearance Officer, National Credit Union Administration, 1775 Duke Street, Suite 5080, Alexandria, Virginia 22314, or Fax No. 703–519–8572, or Email at PRAComments@ncua.gov and the (2) Office of

Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for NCUA, New Executive Office Building, Room 10235, Washington, DC 20503, or email at *OIRA_Submission@OMB.EOP.gov*.

Submission of comments. The NCUA considers comments by the public on this proposed collection of information in:

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the NCUA, including whether the information will have a practical use;
- Evaluating the accuracy of the NCUA's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology; *e.g.*, permitting electronic submission of responses.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the principles of the executive order to adhere to fundamental federalism principles. This proposed rule reduces the number of federally

insured natural-person credit unions, including federally insured, state-chartered natural-person credit unions that would be subject to the 2015 Final Rule. It may have, to some degree, a direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. It does not, however, rise to the level of material impact for purposed of Executive Order 13132.

Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

List of Subjects in 12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on August 2, 2018.

Gerard Poliquin,

Secretary of the Board.

For the reasons discussed above, the Board proposes to further amend 12 CFR part 702, as amended in a final rule at 80 FR 66625 (Oct. 29, 2015), effective January 1, 2019, as follows:

PART 702—CAPITAL ADEQUACY

1. The authority citation for part 702 continues to read as follows:

Authority: 12 U.S.C. 1766(a), 1790d.

§ 702.103 [Amended]

2. Amend §702.103 by removing the words “one hundred million dollars (\$100,000,000)” and add in their place “five hundred million dollars (\$500,000,000).”

[FR Doc. 2018-16888 Filed: 8/7/2018 8:45 am; Publication Date: 8/8/2018]